

Business Rates and Administration Expenses

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Editor's Note: *The notion of an English "floating charge" is entirely foreign to most readers of the ABI Journal. In many Commonwealth countries, the floating charge remains a popular financing tool, as it enables a lender to take security over the shifting stock of a borrower without any need to monitor operations. Upon default, the lender can easily take steps to "crystallise" the floating charge, which then becomes a fixed charge over the assets covered by the charge. In recent years, a very uncomfortable dynamic has been unleashed between the holders of floating charges (usually banks) and those insolvency practitioners (usually accountants with special training) who are appointed by the banks under their floating charges. The issues concern the priority of payment from floating charge realisations. Certain categories of claims are entitled to be paid before the holder of the floating charge, particularly creditors classified as preferential and claims classified as administration expenses. When these issues arise on the basis of decisional law established after the proceeds of realisation have already been paid out to the floating charge holder who appointed the insolvency practitioner, one of the most delicate questions of all might need to be asked: "Although I am very grateful for the fee income that I have earned because you chose me to be the insolvency practitioner on this case, can I please have some of the money I have paid you back?" Read on!*

In *Exeter City Council v Trident Fashions plc*,¹ the English High Court recently considered whether business rates have "super-priority" status as administration expenses in new-style administrations (*i.e.*, those commenced post-Sept. 15, 2003). We have written, on a number of occasions,² about the possible impact on the U.K.'s rescue culture of a liability attaining administration expense status. The issue remains important for U.S. practitioners, since it will determine

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the extent to which assumptions can be made as to the resemblance between chapter 11 and administration procedures. As will be seen, this decision has real consequences that are already being felt by U.K. insolvency practitioners.



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Facts

Trident Fashions plc was the subject of an administration order on Sept. 17, 2003, when the Kroll firm was appointed administrators. At that time, the company owned the leasehold interest in all or most of the 98 retail units from which it traded, including a unit in Exeter. Following a failed company voluntary

office, should be payable as administration expenses under two heads:

1. as expenses properly incurred by the Begbies administrators in performing their functions as administrators of the Company (within the meaning of rule 2.67 (1)(a) of the Insolvency Rules 1986 (the Rules)); or
2. as "necessary disbursements" by the Begbies administrators in the course of the administration of the company (within the meaning of rule 2.67(1)(f) of the Rules).

The main issue in the case was whether rule 2.67 should be given a different interpretation from rule 4.218 (which concerns liquidation expenses and is drafted in similar terms) against the background of the differing purposes and provisions of the administration and liquidation regimes.

Held

Richards J. stated that the decision as to whether rates were administration expenses was one of policy. He held that by adopting the same terms for rule 2.67 as for rule 4.218, the policy decision had been made that rates should rank as expenses in an administration as they do in a liquidation. Although rates were not expenses properly incurred by admin-

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arrangement,³ Kroll resigned as administrators and a firm called Begbies Traynor were appointed in their place. After an extension of the term, the administration finally ended on March 17, 2005. Although a further set of administrators was subsequently appointed out of court by a secured creditor, their appointment was brief as it was clear that the statutory purpose of an administration could not be achieved. The company was finally ordered to be wound up on April 27, 2005.

Since the time of the administration order, both sets of administrators had continued the company's occupation of the Exeter property. Exeter City Council applied for relief that the business rates in respect of the Exeter property, accrued while the Begbies administrators were in

istrators within the meaning of rule 2.67(1)(a), they were "necessary disbursements" within rule 2.67(1)(f).

In reaching this view, he thought that it was critical that the amendments made to the Rules for the introduction of the new administration regime pursuant to the Enterprise Act 2002, included, for the first time, provision as to expenses of the administration in rule 2.67. In particular, paragraph (f) of that rule was for all material purposes identical to rule 4.218(1)(m).

Rates as Administration Expenses: Arguments Against

The Advocate to the Court, appointed to argue in opposition to Exeter City Council since neither the administrator or liquidators appeared at the hearing, suggested that the true meaning and intent of rule 2.67 had to be determined in the

¹ [2007] EWHC 400 (Ch).

² See December/January 2006 and 2007 editions.

³ This is a mechanism whereby a company can reach agreement with its shareholders and creditors that may involve delayed or reduced debt payments or a capital restructuring.

context of administrations and the policy consideration underlining them, which provided a very different context to liquidations. The overriding purpose of the administration regime is to promote rescue of companies and their businesses. Automatically making rates an expense of an administration would seriously jeopardise that purpose. The importance of the rescue culture had been recognised in relation to new-style administrations by the Court of Appeal in *Re Huddersfield Fine Worsteds Ltd.* Furthermore, insolvency practitioners had voiced widespread concern about the issues raised in this case, particularly with regard to the impact on the ability to rescue companies in administration.

The Advocate to the Court argued that the flexibility under the pre-Enterprise Act administration regime should continue, so that in appropriate cases the court could direct the administrator to pay liabilities arising in the administration in accordance with the Court of Appeal's discretionary approach set out in *Re Atlantic Computers plc*. Notwithstanding the substantially identical terms of rule 2.67(1)(f) and rule 4.218(1)(m), the construction of rule 4.218(1)(m) in the context of liquidations by the House of Lords in *Re Toshoku Finance UK plc*⁴ was not applicable given the different context of administrations. The words “any necessary disbursements” in rule 2.67(1)(f) should, he argued, mean disbursements necessary for the purposes of the administration which was, ultimately, a matter for the court in accordance with the flexible approach in *Re Atlantic Computers plc*.

Rates as Administration Expenses: The Reality

Richards J. agreed that it was right to construe the provisions of the Insolvency Act 1986 and the Rules relating to new-style administrations in the light of the underlying purpose of promoting business rescues. He also accepted that the automatic treatment of business rates as an expense of an administration would likely have an adverse effect on the achievement of rescues in “at least some cases.”

However, Richards J. could not accept that the court could disregard the construction put on essentially the same provisions in rule 4.218 by the House of Lords in *Re Toshoku Finance UK plc* and construe rule 2.67 entirely differently. By

using the same terms as rule 4.218, the reasonable inference was that rule 2.67 should carry the same meaning; it could not have been intended to mean that the administrator or the court have discretion as to what were necessary disbursements when that very construction had been rejected by the House of Lords for the purposes of rule 4.218(1)(m). It could not sensibly be suggested that the Insolvency Service⁵ was not fully aware of the House of Lords' decision when rule 2.67 was made.

Consequences of the Decision

Administrators will need to consider the possibility of facing claims from local authorities for the recovery of business rates that went unpaid in administrations that have now been closed. Administrators may argue that they acted on the basis of legal advice in not paying business rates. However, insolvency practitioners were well aware of the risk that rates might be an administration expense before this decision. It might even be suggested that they should have been aware of the issue from as early as the introduction of rule 2.67(1) on the same terms as rule 4.218 (*Re Toshoku*

Finance UK plc had already been decided by then).

One major concern for administrators is that if they do face claims for misfeasance or wrongful harm where business rates have gone unpaid, this could lead to pressure to reimburse their remuneration (which ranks behind necessary disbursements payable under rule 2.67(1)(f)) on the basis that it was paid in breach of statutory duty. Whether administrators might then seek to recover payments made to floating charge holders, who rank behind all administration expenses, raises a number of issues—not least for administrators and their future relationship with such charge holders who might withhold future appointments.

The decision clearly has ramifications for the payment of business rates in existing administrations, and it is likely that administrators will need to be proactive in reaching agreement with local authorities as to their payment. Administrators are also likely to want to take action to minimise exposure to business rates which could, for example, see negotiations with landlords to surrender the lease.⁶

Rates for unoccupied premises would

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⁵ A body operating under a statutory framework that, among other things, advises the government on insolvency, redundancy and related issues.

⁴ The effect of which was that non-domestic rates accruing on premises occupied by a company while in liquidation were payable as an expense of the liquidation under rule 4.218(1)(m) of the Rules.

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also appear to be payable as administration expenses, although they are not payable as liquidation expenses due to a statutory exemption that is not available for companies in administration. This compounds the problem for administrators, particularly in respect of administrations in a retail context or where there might be large numbers of unoccupied properties.

Following the decision, landlords may even seek to argue that rent falling due during the course of an administration might be payable as an administration expense on the basis that it is, in certain circumstances, payable as a liquidation expense: *Re Toshoku Finance UK plc*. The judgment may perhaps be criticised for not giving sufficient weight to the policy differences between administration and liquidation, although Richards J. was clearly well aware of these. However, unless and until the decision is appealed or a change is made to the Rules to clarify the point, in many cases administrators are likely to need to consider whether the relevant objective of the administration can continue to be achieved. The decision may lead to companies seeking to delay going into administration and could see an increase in the use of pre-pack administrations. Depending on the make-

up of any property portfolio, companies may even choose to go into liquidation instead, which would not be helpful in

promoting the rescue culture in the United Kingdom. ■

⁶ It is the occupier of property who is liable for business rates and, for leased property, this will typically be the tenant, so if the lease can be surrendered or if it expires, liability for rates would generally pass back to the landlord.